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# **The Changing Role of Soviet-Owned Banks in the West**

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**An Intelligence Assessment**

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March 1985*

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**An Intelligence Assessment**

This paper was prepared by [ ] Office  
of Soviet Analysis. Comments and queries are  
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## **The Changing Role of Soviet-Owned Banks in the West**

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### **Key Judgments**

*Information available  
as of 1 March 1985  
was used in this report.*

The Soviets have maintained a small but important string of banks in the West since the Russian revolution. Despite Soviet ownership and a high degree of control, the banks, which are located in major international financial centers, operate in the main as independent profit-seeking Western corporations. The six banks and associated branches currently have assets somewhat in excess of \$10 billion. Their main purpose is to promote, facilitate, and finance East-West trade. [ ]

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Although Moscow basically remained aloof from the day-to-day operation of the banks as long as they fulfilled their primary functions, it did from time to time impose restrictions on them for its own benefit and at some inconvenience (and cost) to the banks. The banks' fundamental role, and their relationships with each other and with Moscow, began to change in the late 1970s under the guidance of new State Bank Chairman Vladimir Alkhimov and as the Soviet apparatus sustained a series of financial setbacks:

- The repercussions of poor investments—totaling nearly \$500 million—by the foreign-based banks depressed profits and impeded lending.
- The Polish financial crisis forced Moscow to reevaluate its financial relationships with its East European allies.
- A corresponding skepticism grew in the West over Bloc creditworthiness in general.
- Moscow's demand for hard currency surged in 1981 and 1982 as the USSR had to pay for stepped-up purchases of agricultural imports at the same time that world oil market prices began to soften. [ ]

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Moscow reacted to these crises by ordering an across-the-board retrenchment that has led to a fundamental restructuring of its relationship with its foreign banks. Although the Soviets have always kept a close eye on their banks, the Soviet State Bank and the Soviet Bank for Foreign Trade (VTB) now do a great deal more than just set policy for the overseas banks. Moscow now sets country lending limits, reserves the right to approve or disapprove specific deposit operations, and is handling gold sales and purchases directly. The biggest change, however, probably has been VTB's repeated and continuing demands to all Soviet overseas banks to raise and forward cash—in fact, all surplus money—to Moscow, at the expense of other banking operations. This instruction, and the insistence with which it was relayed, is impinging on the banks' original charter—to finance East-West trade. [ ]

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Indeed, Moscow's continued micromanagement of the banks could threaten their long-term viability. Although still fundamentally sound, all the banks have experienced some erosion of key financial indicators. Three years of declining liquidity and profitability leave them today less viable, and thus more vulnerable to a deterioration of their capital bases, should Moscow continue to press its demands for cash. In the worst possible case, if there is no change in current Soviet needs and policies, Moscow might face the loss of as many as four of the banks—the smaller and newer ones.

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In purely financial terms, the USSR could sustain these losses with little effect on its own activities in world markets. If necessary, Moscow could support the full range of Soviet trade activities in the West with just the two largest banks—Moscow Narodny Bank (MNB) and Eurobank—although with greatly diminished credibility and flexibility. All of the important markets—gold, diamonds, other precious metals and gems, Eurocurrencies, bonds and other securities, and commercial paper—are now truly international in scope and operate around the clock. MNB and Eurobank could easily be Moscow's eyes and ears in these markets as well.

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However, the effects of such losses in nonfinancial terms would be substantial. The foreign-based Soviet-owned banks provide Moscow with windows to the West through which knowledge, as well as money, passes—and in both directions. They inform local business people of Soviet import needs and products available for export. The banks are in an excellent position to collect economic and trade intelligence; they participate in local markets and have widespread contacts among local traders and market analysts.

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It is at least equally noteworthy that through their overseas banking network the Soviets have readymade entree to cities that offer political opportunities as well as financial access.

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Because the political fallout from a massive bank retrenchment would be so large, and the cost of keeping the banks afloat is so relatively small, Moscow would no doubt be reluctant to set any of its banks adrift.

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### Historical Overview

*The USSR initiated its overseas banking operations in 1919 with the purchase of Moscow Narodny Bank (MNB) in London. By 1923 the USSR had three banks operating abroad, having opened Banque Commerciale pour l'Europe du Nord in Paris (Eurobank or BCEN) and Bank Russo-Iran in Tehran. In 1926 MNB opened its first branch in Berlin. During the 1920s, the banks' primary purpose was to help Soviet trading organizations reestablish foreign commercial ties, which had been disrupted by the revolution. With the onset of the 1930s and the depression, bank activity was reduced to a de facto caretaker status. The MNB Berlin branch was closed in 1935 in response to the anti-Bolshevik attitude of the German Government, and Eurobank closed in 1940 when the Germans invaded Paris.*

#### Postwar Years

*Following World War II, several factors worked to further restrict the banks' activities and effectiveness. Initially, the USSR was preoccupied with promoting trade with Eastern Europe and thus was only marginally interested in reestablishing its prewar ties with the West. The tensions of the then beginning Cold War period further discouraged dealings with Soviet banks. This does not mean that the Soviet record was all negative, however. When left to their own devices, the Soviet banks managed some clear successes. Eurobank, for instance, reopened after the war and*

*was able to expand its presence and become a leading force in the emerging Eurodollar market. As a result, by 1960 it and MNB had developed into modern, diversified commercial banks. During the mid-1960s, the banks were able to capitalize on their positions as Soviet commercial outposts in the West and the blossoming of East-West trade as they became focal points for Western corporations wishing to do business with the USSR or other CEMA countries. They established solid reputations in this period, which has facilitated growth since then.*

*Building on the financial strength and reputation of the older banks, Moscow doubled the size of its overseas financial network in the sixties and seventies. The additions of Wozchod Handelsbank and Ost-West Handelsbank gave the USSR entree to the Swiss international gold market and to the Frankfurt international diamond market, respectively. Moscow Narodny Bank's two new branches in Beirut and Singapore were able to tap into the growing Arab and Asian dollar markets and greatly increased Moscow's flexibility in financing trade. After Donaubank opened in Vienna in 1974, the Soviet overseas banking network remained fairly stable until the nationalization of the Russo-Iran Bank in 1980. Most recently, in August 1984 MNB established a small financial subsidiary in the Netherlands to facilitate the issuance of a \$50 million Eurobond.*

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## The Changing Role of Soviet-Owned Banks in the West

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### Introduction

The Soviet Union currently maintains six banks and several branches in major international financial centers. This foreign-based banking network, which formally began with the chartering of Moscow Narodny Bank (MNB) in London in 1919, has played a major role in Soviet commercial relations with the West, both as a conduit of hard currency into the USSR and as a promoter of East-West trade. In recent years, however, the financial viability of the Soviet-owned banks has been strained. Initially—in the 1970s—poor business decisions damaged the reputations of the banks and restricted bank financial operations. More recently, constrained international financial markets, the downturn in Bloc financial fortunes, and the generally cooler East-West climate have combined to impinge on bank operations. Moscow's response to the growing problems the banks have encountered has been to step in and assume a far greater hand in managing their day-to-day operations.

This assessment details Moscow's evolving relationship with its overseas banks

It provides a historical perspective on each of the banks the Soviets maintain in the West and the links they maintain with Moscow. The paper includes an evaluation of past bank financial performance and examines current bank viability through analysis of the available financial data. It ends with an assessment of Moscow's future options.

The financial analysis presented in the paper is based primarily on unclassified bank-generated financial statements available through commercial subscription. Data for some banks are current through year-end 1983 but insufficient in detail to allow comprehensive analysis prior to 1981. Such gaps in the data have not, we believe, influenced the outcome of the

analysis. (Histories, detailed financial statements, and current peer group comparisons for each individual bank are presented in the appendixes to this assessment.)

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### The Soviet Banking Network

In the post-World War II period, the growth of the Soviet overseas banking network generally has paralleled Soviet interest in trading with the West. Moscow Narodny Bank opened a branch in Beirut in 1963 and another in Singapore in 1971. Four additional Soviet-owned banks were established in Europe from 1966 to 1974, and Bank Russo-Iran opened a branch in Isfahan in 1975. Thus, at its peak in the late 1970s, the USSR's overseas banking system consisted of seven banks and three associated branches, all located in major international financial centers. In 1980, however, the USSR lost its banking operation in Iran when the government nationalized foreign businesses.

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### The Operating Environment

The Soviet-owned banks in the West vary widely with respect to size, asset structure, and scope of activity. All of the banks are chartered in the countries in which they are located and operate subject to the laws and regulations of those countries. Thus, Moscow Narodny Bank is legally a British bank rather than a Soviet one. In fact, MNB and Wozchod maintain business representative offices in Moscow just as any other Western corporation might.<sup>2</sup> Moreover, MNB in

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<sup>2</sup> A representative banking office functions as a liaison between the parent bank and the business and financial community where the office is located. Thus, although it cannot make loans or accept deposits, it serves to make and maintain contacts, promote trade, and otherwise "represent" the parent bank.

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London, MNB in Singapore, and Eurobank have all clashed with local bank employee unions and been picketed by workers on strike. [redacted]

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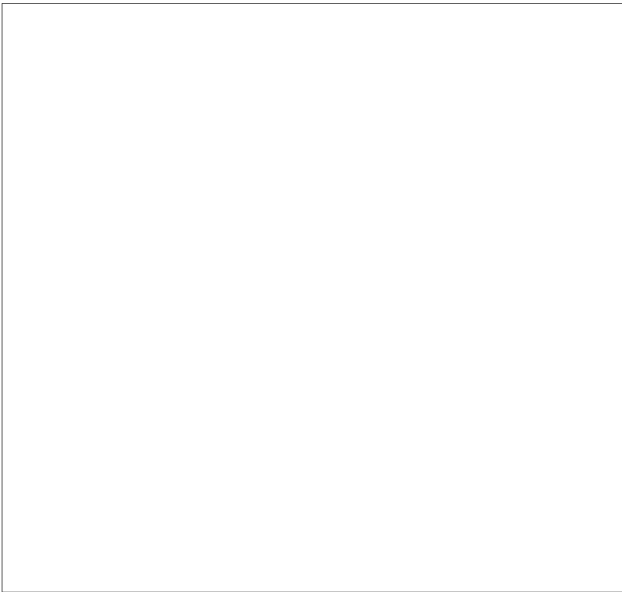
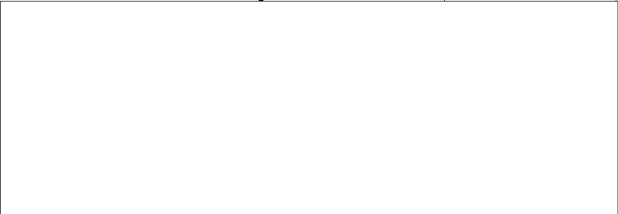
Like other Western companies, the Soviet-owned banks are publicly held corporations with ownership legally unrestricted and held in the form of stock. In practice, however, the Soviet-owned banks in the West remain just that—Soviet owned. Stock ownership is retained solely by various organizations within the Soviet foreign trade infrastructure [redacted]

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**Management**

Upper-level bank management, like bank ownership, is an almost exclusively Soviet domain. [redacted]

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bad luck, several of the banks experienced major financial setbacks. MNB Singapore was defrauded of about US \$300 million in 1974 by a real estate speculator, a setback that the branch is still laboring to overcome. Donaubank invested in a plastics firm and a local private bank, both of which folded very soon after opening; the bank lost almost all of its initial capital—about US \$5 million—in its first year of operation and Moscow had to completely refinance it. Ost-West Handelsbank, apparently trying to find an area of specialization like Wozchod's specialization in gold, invested heavily in the much-heralded, but short-lived, Frankfurt International Diamond Bourse. Losses totaled in the hundreds of millions of dollars.

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#### Span of Control

The Soviet-owned banks in the West are closely tied to Moscow, despite their physical distance from it, and a complex infrastructure has developed there to deal with them (see figure). The Banking Supervisory Council, which reports directly to VTB, is composed of representatives of Gosbank, VTB, and some of the larger Foreign Trade Organizations (FTOs); it sets policy for and supervises the operations of these banks.

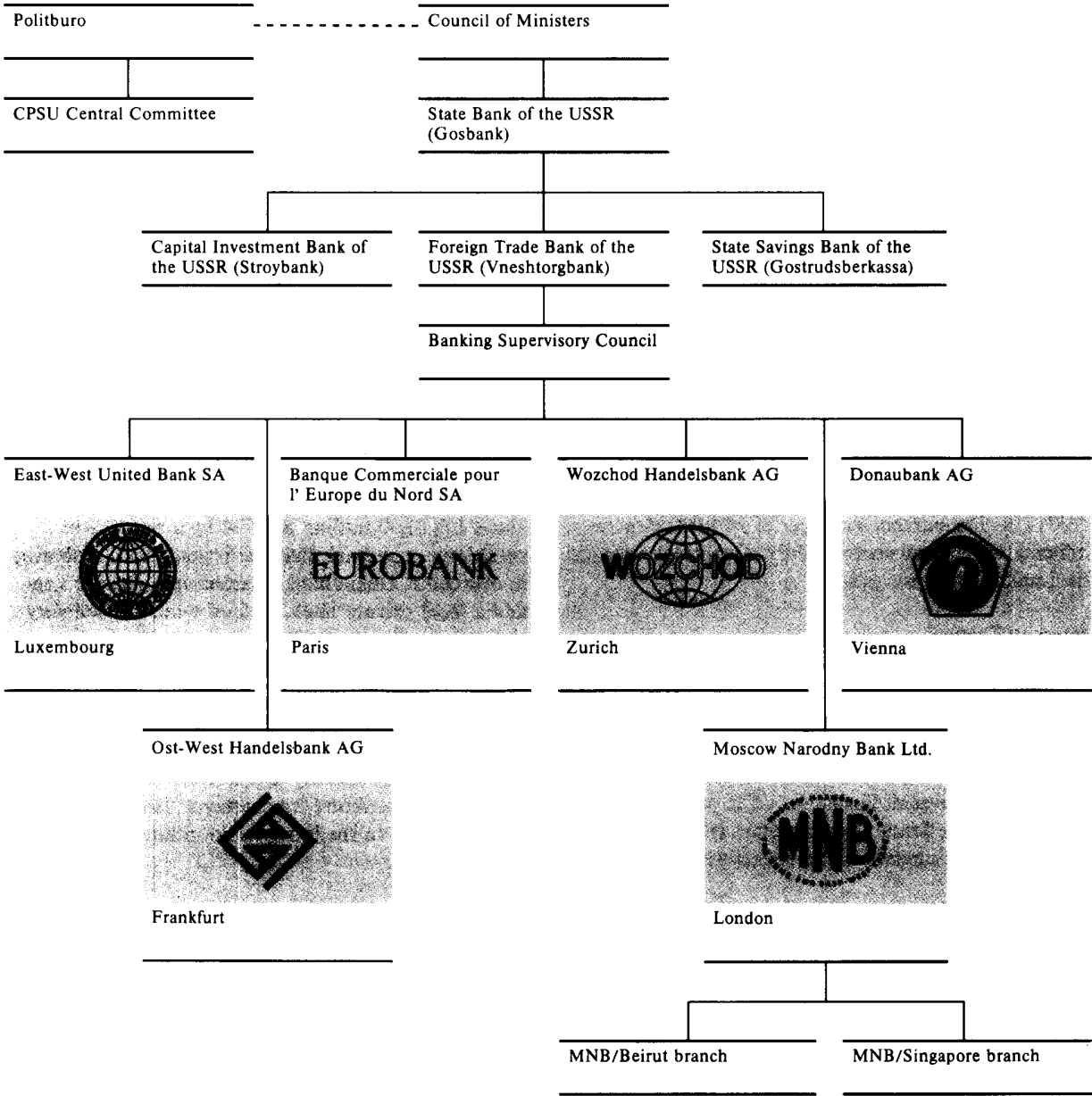
The extent of the direct control that Moscow has chosen to exercise over its overseas banks has varied over time. Although Gosbank closely monitored MNB and Eurobank in their early years, by the end of the fifties the two banks had proved themselves capable of self-management. When the USSR began to expand its foreign-based banking network in the sixties and seventies, the new banks were thrown into the international banking community under inexperienced management and with only loose control and monitoring by Moscow. As a result of both mismanagement and

In response to its financial problems, Moscow has been trying to keep the banks on a much shorter rein since 1976. The most easily discernible result of this policy is that all of the banks are now building much more conservative portfolios and avoiding risky long-term investments—such as real estate, an area in which they were twice burned. Moscow, especially

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USSR: Foreign Financial Apparatus\*



\* This figure represents the chain of command for actual banking operations. Several of the Soviet-owned banks in the West maintain representative offices in Moscow or elsewhere, or are part or full owners of other businesses.

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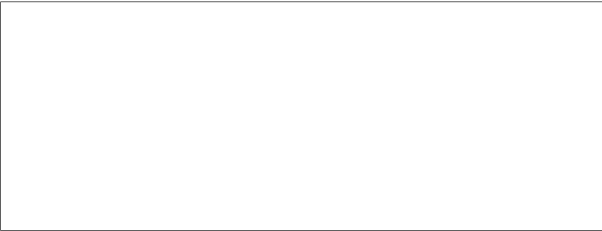
fearful of being hurt by Eastern Europe's debt problems, further increased its micromanagement following the deterioration in its own hard currency position in 1981. This has sometimes led to a worsening of working relations between the Soviets on the scene and their locally hired employees. [redacted]

**Bank Activities**

The primary role of the Soviet-owned banks in the West has been to foster and finance East-West trade. In addition to carrying on the normal business activities of all banks—accepting commercial deposits and making loans, providing financial analysis and advice—they make special efforts to encourage trade with the USSR and Eastern Europe. To this end, Soviet bankers overseas:

- Advise Westerners about Soviet import needs and export offerings.
- Assist businesses in the intricacies of trade-related documentation.
- Provide short- and medium-term financing for specific East-West commodity trade deals.
- Manage and generate broad-based participation in East-West commercial loan syndications. [redacted]

Some of the banks took on additional, more specific functions in the late 1970s. As has been noted, Wozchod has served a specialized function as a primary marketer of Soviet gold. East-West United Bank has played a similar role as an early participant in the Eurodollar loan market, and Eurobank was a major source of financing for Soviet sugar and grain imports over the last several years. Most of the Soviet-owned banks have also traded heavily in Soviet and East European commercial paper in the *à forfait*<sup>3</sup> market, relying heavily on this market to encourage trade with the East. [redacted]



<sup>3</sup> *Forfaiting* (*à forfait*, *Forfaitierung*) is generally used to define the purchase of financial obligations falling due at some future date, arising from deliveries of goods and services—mostly export transactions—without recourse to any previous holder of the obligation. [redacted]



**Recent Trends**

Before the USSR's international banking network had recuperated from the financial fiascos of the mid-1970s, the international banking scene had changed drastically. Moscow reacted with an abrupt

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**Soviet Responses to Recent Events**

**Event**

*In the mid-1970s Moscow Narodny Bank in Singapore, Ost-West Handelsbank, and Donaubank suffer losses totaling nearly half a billion dollars as a result of risky loans.* [redacted]

*Poland enters a financial crisis, and hints of other financial problems in Bloc countries emerge.* [redacted]

*The USSR experiences a temporary, but severe, hard currency crunch compounded by Western banks turning away from Eastern Europe.* [redacted]

*The USSR is unable, because of slow and inflexible gold marketing procedures, to take full advantage of a strong gold market to meet its hard currency needs.*  
[redacted]

*The confrontational East-West political climate dries up the Soviet foreign-based banks' usual sources of funds.* [redacted]

**Response**

*The USSR begins to oversee portfolio development at all the overseas banks and reserves the right to veto anything too risky.* [redacted]

*Moscow lowers bank lending limits for CEMA countries.* [redacted]

*The Soviets demand transfers of cash from their Western-based banks.*  
[redacted]

*VTB takes direct control of Soviet gold sales away from the overseas banks.* [redacted]

*Gosbank instructs the banks to find new financing methods and pushes them to seek cash infusions from Arab banks.* [redacted]

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retrenchment. During 1977-81 the relationship between the Soviet Government and its banks abroad appears to have shifted from benign and rather aloof oversight to a tighter control over day-to-day bank operations. This tightening up followed closely the appointment of Vladimir Alkhimov as chairman of Gosbank. Mr. Alkhimov had long been a student of international finance and seems to be trying to lead the Soviet-owned banks in the West into the modern era. Although the crises that initially spawned the Soviet concern have eased, Moscow appears to be continuing to maintain tight control over its banks in the West. Each new retrenchment, compounding the effects of previous such moves by Moscow, has served to further restrict the banks' options. [redacted]

**Risky Loans**

As the USSR's hard currency trade deficits grew in the mid-1970s, the overseas banks came under pressure from Moscow to increase their hard currency earnings. The banks responded by deemphasizing their traditional and relatively risk-free activities in

financing East-West trade and turned instead to far riskier—if potentially more lucrative—investments in real estate and other local lending. One Western observer noted at the time that the banks “suddenly began engaging in and tolerating reckless operations. They made all the mistakes the capitalists made. In addition, they made mistakes all their own.” [redacted]

Moscow reacted to these setbacks by pulling back and refocusing the banks on conservative investment portfolios and trade financing. VTB reserved to itself the right to approve new investments and began to audit the banks more frequently to spot early danger signs. Senior personnel in the errant banks were replaced with bankers more responsive to Moscow's needs. These changes left several of the Soviet-owned banks basically dormant; they finance local trade with the USSR as needed and stand ready to participate in Soviet loan syndications—and little else. [redacted]

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**Financial Problems in the Bloc**

Many Western bankers, subscribing to the umbrella theory, believed that the USSR would assist its East European neighbors in their financial relations with the West. Moscow had been allowing its own Western-based banks to make somewhat riskier loans to Eastern Europe than to the rest of the market for some time.<sup>4</sup> At the same time that Western banks were reevaluating their lending practices with regard to Eastern Europe, and coinciding with Moscow's own liquidity problems, in 1981 the Soviet Banking Supervisory Council reduced credit limits for Socialist Bloc countries. The net effect was to put lending to Bloc countries on the same basis as lending to Western customers. The situation has been particularly troublesome to MNB and BCEN; Czechoslovakia and East Germany have sizable deposits at the two banks.

**The Hard Currency Crunch**

In the summer of 1981 Moscow began to press its overseas banks to help rebuild the USSR's depleted asset reserves by supplying the State banks with excess hard currency holdings. In the first half of the year, Soviet holdings in the West fell from a comfortable level of more than \$8 billion to only about \$3.5 billion, an amount equal to only a month or two worth of imports, insufficient to comfortably finance day-to-day trade. VTB has continued to levy demands for cash on the Soviet-owned banks in the West, even though the Soviet hard currency crisis has eased since then.

**Marketing Gold**

Although Moscow established the Wozchod Handelsbank in Zurich to attain ready access to the largest international gold market, Wozchod's preeminence in this field has been declining because of disagreements among Soviet financial managers.

<sup>4</sup> Country lending limits imposed by Moscow for client states have on occasion been taken by Western bankers to represent a guarantee by Moscow for repayment of loans. If these are, in fact, guarantees, they are not reported as such to the Bank of England, nor, presumably, to other Western government "watchdogs."

**New Sources of Funds**

Just as the last few years have brought a redirection in the lending activities of the Soviet-owned banks, they have also seen a change in their sources of funds. In the tense economic and political climate of recent years, Western banks reduced funds on deposit with the Soviet-owned banks. This dropoff in Western capital led the Soviet-owned banks to rely more heavily on the USSR as a source of funds. Because of increased placements with its subsidiary banks in the West, the USSR's deposits with other Western banks fell in 1982 and 1983, from 85 percent to 70 percent of Moscow's total holdings in Western banks.

VTB has been exhorting the overseas banks to explore more creative, though somewhat riskier, financing methods. As a result, MNB in London recently issued \$50 million in floating-rate notes. (Floating-rate notes

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are similar in concept to domestic adjustable rate mortgages. The notes have been on the market for several years but have only recently come into use by commercial banks.) Informed that it was illegal for private banks in the United Kingdom to issue such notes, MNB—like other British banks before it—opened a small subsidiary in the Netherlands from which to make the issue. The relatively small size of the offering may indicate that MNB is just testing the water. If successful with this first marketing, MNB may look to floating-rate notes to replace some of its more expensive fixed-rate bond offerings. [ ]

### Financial Analysis of Overseas Banks

Bank analysts have at their disposal several dozen indicators of the soundness of a financial institution. Banks are usually examined according to standard criteria and in comparison with their financial “peers”—other banks of similar asset size—in the same market or industry. Unfortunately, straightforward ratio analysis of the Soviet-owned banks in the West is hampered by the dearth of financial data available on them, especially prior to 1981. We have performed a bank analysis for the recent period to study the banks’ prospects for the future in a purely financial context. We believe the gaps in the data have not substantially biased the financial analysis. [ ]

Overall, the Soviet foreign-based banks are undercapitalized, less liquid than their peers, and not very profitable (see tables 3 and 4). Deposits in the four largest Soviet-owned banks in Europe fell in the most recent period, probably because of East-West tensions, while capital also declined at three of them because of unprofitable operations. As a group, total assets of the network have also been declining—from a peak of \$12.2 billion in 1980 to about \$10 billion at yearend 1982.<sup>6</sup> At the same time Moscow has closely monitored its overseas banks; VTB has been careful to

<sup>6</sup> Throughout our analysis the assumption is made that each bank holds all of its assets and liabilities in the currency in which the accounts are reported—that is, all of BCEN’s assets are in French francs. In fact, we know that bank assets are held in some unknown mix of currencies. We assume, therefore, that appreciation in any one currency will be offset by depreciation in another, netting to zero. [ ]

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### Financial Analysis Criteria

Liquidity can be viewed in two related ways: (1) how well assets cover liabilities—using a ratio of loans (medium- and long-term assets) to deposits (short- and medium-term liabilities); and (2) nearness of assets to cash—using a ratio of quick assets (nearest to cash; that is, readily salable) to deposits. Each indicator measures the ability of a financial institution to pay off its creditors in the event of a financial crisis. [ ]

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Capital serves three basic functions—to cushion against temporary losses, to protect creditors in the event of liquidation, and as an indicator of how well a bank’s operations can be sustained. Capital adequacy—the ratio of capital to total assets—is constantly being evaluated by the financial markets. If it becomes insufficient in the eyes of the market watchers, the bank could find it increasingly difficult to attract new funds. [ ]

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The ratio of net income to total revenue—a profitability measure—indicates the portion of its revenue that a bank can add to capital or free reserves or distribute to its owners as dividends after all expenses are paid. Another criterion of profitability is change in deposits, which reflects the market’s aggregate opinion of the soundness of a bank. [ ]

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Peer-group analysis consists of comparing the ratios described above for the subject institutions to the same ratios for institutions of like asset size and market. This examination of a bank’s standing relative to its peers helps to account for apparently large ratio shifts, which are in fact the result of widespread market conditions. Each Soviet bank was compared where possible to four such banks of like asset size in its home country and four banks of like asset size worldwide. A rank of “1” in this paper will always denote the highest standing in a given peer group. [ ]

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**Table 3**  
**USSR: 1982 Peer Group Analysis Summary <sup>a</sup>**

	Liquidity		Capital Adequacy (Capital/ Assets Ratio)	Profitability	
	Loans/Deposits Ratio	Quick Assets/ Deposits Ratio		Net Income/ Revenue Ratio	One-Year Change in Deposits
Moscow Narodny Bank (percent)	82.2	22.6	4.3	NA	-10.4
Rank in British peer group	3	5	2	NA	4
Rank in international peer group	4	5	4	NA	4
Eurobank (percent)	24.9	74.4	1.9	1.4	-13.2
Rank in French peer group	1	1	1	2	4
Rank in international peer group	1	1	3	3	3
East-West United Bank (percent)	8.7	94.6	4.3	0.5	-20.5
Rank in Luxembourg peer group	1	1	1	3	4
Ost-West Handelsbank (percent)	71.4	32.9	3.6	0.8	-9.1
Rank in German peer group	1	1	2	3	4
Wozchod Handelsbank (percent)	98.8	9.0	7.5	9.5	-12.2
Rank in Swiss peer group	5	5	3	1	3
Donaubank (percent)	58.4	44.0	3.6	0.2	15.9
Rank in Austrian peer group	2	2	2	4	1

<sup>a</sup> A full breakdown of the peer group financial data used to generate this table is available in the appendixes to this paper. Rank refers to the Soviet-owned bank's rank in a peer group of five where one always denotes the best standing.

keep sufficient funds on deposit with them to allow the banks to carry out their basic East-West trade charter and service Moscow's other monetary needs.<sup>7</sup> The Soviet banks are slowly losing ground in their various peer groups according to most criteria. Soviet bankers sitting in Moscow are more concerned about

<sup>7</sup> The funds Moscow deposits with its overseas banks are generally short term and earn higher-than-market interest rates. The money it borrows from those same banks is usually long term at lower-than-market interest rates.

the USSR's own financing needs than they are about whether the overseas banks are well respected by their peers.

#### **Liquidity**

Four of the six Soviet-owned banks in Europe seem to be sound with regard to liquidity, ranking first or second in their respective peer groups. Eurobank is, in

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**Table 4**  
**USSR: Soviet-Owned Banks—**  
**Combined Balance Sheet Data <sup>a</sup>**

Million current US \$

	1979	1980	1981	1982	1983
<b>Assets</b>					
Cash and notes due from banks	5,618.6	6,069.4	5,820.1	4,947.5	4,578.6
Investments	429.9	407.3	277.8	278.4	97.3
Loans and advances	5,119.5	5,425.9	4,805.8	4,454.4	5,328.6
Other assets	271.4	268.8	237.1	202.1	157.8
<b>Total</b>	<b>11,439.4</b>	<b>12,171.1</b>	<b>11,140.6</b>	<b>9,882.6</b>	<b>10,162.1</b>
<b>Liabilities and net worth</b>					
Deposits and notes due to banks	10,772.8	11,426.0	10,414.0	9,223.7	9,492.0
Other liabilities	281.5	326.1	296.8	259.1	253.7
Capital	294.4	319.1	339.5	303.9	319.1
Surplus, profits, and reserves	90.7	99.9	90.1	96.0	97.1
<b>Total</b>	<b>11,439.4</b>	<b>12,171.1</b>	<b>11,140.6</b>	<b>9,882.6</b>	<b>10,162.1</b>
Percent change		6.4	-8.4	-11.2	-2.8

<sup>a</sup> Because of rounding, components may not add to the totals shown. Actual yearend bank-reported data except for: Wozchod Handelsbank—1983 data are through third quarter only; and Donaubank—1983 data are estimated on the basis of 1980-82 trends.

fact, the most liquid of both its French peer group and its international peer group. Eurobank, East-West United, and Ost-West could probably weather almost any financial crisis they might face in the near future because—relative to their peer groups and markets—a sufficient amount of their assets are held as cash or near cash.

Our liquidity analysis indicates that MNB and Wozchod are the most vulnerable to being damaged by a serious and unexpected cash drain, probably a lingering legacy of the Singapore fiasco. Although MNB showed a small improvement in liquidity during 1981 and 1982, it nonetheless continues to hold less than a fourth of its assets as cash or near cash—well below the average for either of its peer groups. Furthermore, MNB also has a loan-to-deposit ratio that is well above average, which suggests that it would have a hard time liquidating assets quickly enough to cover a major run on its deposits. Both Donaubank and MNB

have been chastised by Moscow in recent years for their poor liquidity positions. (MNB has the dubious distinction of also having been scolded for its poor liquidity position by its *other* monetary authority—the Bank of England.)

#### Capital Adequacy

Although our analysis of capital ratios shows that the Soviet foreign-based banks are about average in the capital/assets ratio for their markets, it also suggests that the banks are having difficulty attracting deposits. During 1982 bank deposits dropped an average of 11.4 percent, more than three times the average 3.2-percent drop in country peer group deposits. East-West United Bank experienced the worst decline—20.5 percent, more than four times the decline for the

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Luxembourg peer group. That the peer group average for the period also declined clearly indicates deposits were hard to come by throughout the European banking community. The Soviet-owned banks cannot, however, have their deposits decrease at triple the annual community average and continue to be competitive. [ ]

#### **Profitability**

On the whole, the Soviet-owned banks in Europe rank toward the middle of their respective peer groups with respect to profitability. Eurobank's profitability increased even though it decreased for both of its peer groups, and its deposits dropped by over 13 percent. East-West United Bank, on the other hand, experienced lower profitability despite an increase for its peer group. [ ]

#### **Prospects for the Future**

Moscow's continued micromanagement of its banks in the West could threaten their long-term viability. Although the banks are currently sound, their financial status—as well as their stature among other international banks—has been eroded by three years of cash drain. For example, East-West United Bank, which has been left without funds that it used to place into syndication, has been largely dormant since 1980, and had a profit of only 0.5 percent in 1982. This steady downward drift in liquidity and profitability leaves the Soviet-owned banks in the West vulnerable to further deterioration of their capital base—and eventual insolvency. [ ]

Furthermore, if VTB continues its pressure on the banks to raise large sums of hard currency quickly, it may force them to sell some profitable longer term investments. Several of the banks, in fact, already have had to reduce investments to accede to Moscow's guidelines, an action that has led to corresponding drops in interest income. Soviet bank operations are also being hampered by perceptions among Western bankers that:

- The banks are not independent financial entities but rather political extensions of Moscow.
- Soviet managerial personnel sent to the banks in the West are generally not selected on the basis of professionalism and quality of training.

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#### **Country Risk Versus Commercial Risk**

*Financial institutions assess loan applicants—individuals, companies, other banks, or governments—according to commercial or credit risk criteria. These institutions attempt to determine, on the basis of past credit behavior and future earning potential, the likelihood of repayment of the loan. In the case of individuals, this evaluation of personal commercial risk is called a credit rating and resides in the data base of one or more credit bureaus who provide the information to businesses for a fee. No set formula exists for assessing a country's credit risk, however. A basket of indicators—based on foreign debt or debt service payments as a share of GNP, total exports, or another baseline indicator—is frequently used, but incomplete or untimely data—especially from Bloc countries—make it difficult to perform even this rudimentary analysis.* [ ] 25X1

*The evaluation is further complicated when the loan is international in scope, however, because a second criterion—that of country or political risk—is also taken into account. This assessment evaluates the probability that political upheaval external to the loan recipient itself will affect or prevent the repayment of the loan. To illustrate, if Renault, a French company, planned to build a new plant in Brazil and sought financing for the project from a French bank, the bank would evaluate Renault for commercial risk and either Brazil or France or both for political risk. The question of political risk is even more complex in a multipartner case. If, for example, a Renault subsidiary unit in Argentina wanted to build a factory in Brazil, the French bank would have to decide whether to evaluate the country risk of Brazil, Argentina, or France.* [ ] 25X1

*The Soviet-owned banks in Western Europe tend to portray themselves as exempt from country risk evaluations because of their ties to the Soviet Government, which, they contend, is risk free. Western financial experts take exception to this assertion.* [ ] 25X1

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- The professional local bank management increasingly is being prevented from making business decisions on the basis of rational financial criteria.

[redacted]

[redacted] Moscow will most likely continue to demand as much from its overseas banks as it can without actually pushing them under, and at the same time it will keep a close watch for external threats to the system. [redacted]

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In purely financial terms, loss of the smaller banks would not substantially hamper Moscow—they are nearly dormant already. East-West United Bank and Ost-West Handelsbank are just barely profitable, and Wozchod has been phased out as the primary marketer of Soviet gold. At some point, Moscow could decide to write them off as financial losses and restructure the remaining banks to carry on without them. MNB and Eurobank are much larger than any of the other Soviet-owned banks in the West and have appropriate connections and experience in all the major markets—gold, Eurocurrencies, diamonds, equity securities.

[redacted]

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However, a reduced Soviet banking presence in the West, in addition to decreasing prestige in Western markets, would severely curtail Soviet flexibility in financial and trade activities. Although Moscow obtains the bulk of its financing from non-Soviet Western banks, the Soviet-owned banks have always functioned as Moscow's financier of last resort, unable to turn down a "request" from the stockholders even if it is financially unattractive or unsound. Without its foreign financial organs, the USSR would find it more difficult to line up the most favorable commercial financing. Furthermore, the Soviets would have to conduct their trade financing through more cumbersome Western channels. Thus, the USSR could find that carrying on foreign trade would be both more costly and more inconvenient. [redacted]

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**Appendix A****Moscow Narodny Bank (MNB)****History**

The London-based Moscow Narodny Bank (MNB)—the flagship of the USSR's overseas banking network—was founded in November 1915 as a branch of Moscow's Moskovskiy Narodniy Bank. In 1919, following the Russian revolution, MNB was incorporated as an independent British bank and remained under the direction of White Guard sympathizers until 1924, when the new Soviet Government successfully wrested control away. MNB flourished under the new economic policy of the late twenties, and, by the end of its first decade, it had opened branches in Paris, New York, and Berlin. Business began to fall off sharply in the depression, forcing closure of all the new branches. World War II and the Cold War tensions in its aftermath kept business activity depressed until the late 1950s. [ ]

The expansion of East-West trade during the 1960s led to a rebound in MNB's asset position, but by the mid-1970s the Singapore branch's reckless lending again slowed MNB's overall growth. Toward the end of that decade, MNB reduced its presence in the syndicated loan market but continued to be active in the foreign exchange markets and in sponsoring loans to Eastern Europe. Since 1981 MNB has also cut back this activity and now concentrates primarily on routine operations associated with East-West trade financing and gold marketing. [ ]

**MNB in Beirut**

In October 1963 MNB opened a branch in Beirut—the first Communist-owned bank in the then-thriving financial center—to facilitate trade and financial operations in the Middle East. Ten years later the Beirut branch was reported to be the third-largest bank in Lebanon. In the past two years, the Beirut office has been dormant. The bank has cut back its overall operations, reduced levels of cash held in Lebanese pounds to the minimum needed for daily business, and sold its high-rise office building. In May 1983 all Soviet dependents were evacuated from

Beirut, and most of the local Lebanese work force was laid off. These moves were designed to facilitate a decision to pull out of Lebanon suddenly, should one be made. [ ]

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**MNB in Singapore**

A second MNB branch was opened in Singapore in 1971, primarily to tap the burgeoning Asian dollar market and to facilitate Soviet trade with Southeast Asia and, to a lesser extent, with Australia and New Zealand. Initially, the bank in Singapore grew rapidly—by 1973 the branch reportedly was one of the three largest foreign-owned banks in the country. The branch ran into trouble in part when it started deemphasizing relatively risk-free East-West trade financing in favor of more profitable but high-risk, and undersecured, real estate loans. The bank's loose credit policy led to major loan writeoffs that may have amounted to as much as US \$300 million. In recent years, the bank has maintained a decidedly more conservative profile and concentrated on marketing Soviet gold and diamonds and financing Soviet-Asian trade. [ ]

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**Table A-1**  
**Moscow Narodny Bank Balance Sheet—**  
**Combined Branches <sup>a</sup>**

Million US \$

	1979	1980	1981	1982	1983
<b>Assets</b>					
Cash and notes due from banks	830.3	971.9	553.3	571.6	847.8
Loans and advances	2,646.1	2,722.5	2,412.2	2,079.4	2,307.8
Investments	23.2	25.2	20.9	14.7	20.7
Other assets	15.2	17.3	15.0	16.5	10.9
<b>Total</b>	<b>3,514.8</b>	<b>3,736.9</b>	<b>3,001.4</b>	<b>2,682.1</b>	<b>3,187.0</b>
<b>Liabilities and net worth</b>					
Deposits and notes due to banks	3,385.5	3,560.6	2,823.8	2,530.6	3,017.7
Other liabilities	3.9	8.2	10.3	6.2	9.5
Capital	100.1	135.9	137.4	116.2	129.7
Surpluses, profits, and reserves	25.3	32.2	29.9	29.1	30.1
<b>Total</b>	<b>3,514.8</b>	<b>3,736.9</b>	<b>3,001.4</b>	<b>2,682.1</b>	<b>3,187.0</b>

<sup>a</sup> Yearend data; because of rounding, components may not add to totals shown. Data for 1979-82 are audited according to generally accepted accounting principles (GAAP); 1983 data are unaudited.

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**Table A-2**  
**Moscow Narodny Bank Peer Group Comparison, 1982 <sup>a</sup>**

	Total Deposits		Total Capital		Liquidity		Capital Adequacy (Capital/Assets)	Return on Income (Net Income/ Revenue)	Return on Equity (Net Income/ Capital)
	Million US \$	Rank in Peer Group	Million US \$	Rank in Peer Group	Quick Assets/ Deposits	Loans/ Deposits			
United Kingdom peer group									
Moscow Narodny Bank	2,531	1	116.2	1	23	82	4	NA	NA
Banque National de Paris	2,463	2	97	4	43	69	4	NA	NA
Libra Bank	2,194	3	105	2	29	85	4	NA	NA
Johnson Matthey Bankers	468	4	112	3	NA	55	6	NA	NA
Smith St. Aubyn Holdings	73	5	17	5	NA	NA	1	NA	NA
International peer group									
Moscow Narodny Bank, London	2,531	2	116.2	4	23	82	4	NA	NA
Canara Bank, Bangalore	3,152	1	21	5	44	59	1	2	23
Arab-African International Bank, Cairo	2,082	3	196	2	55	56	8	8	12
Banca della Svizzera- Italiana, Lugano	2,032	4	173	3	34	59	7	7	9
Banco Real, Sao Paulo	837	5	239	1	59	159	11	6	15

<sup>a</sup> Peer groups were generated on the basis of total assets at yearend 1981.

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## Appendix B

Banque Commerciale  
pour l'Europe du Nord  
(BCEN)—Eurobank

## History

Eurobank was founded in 1921 by white Russian emigres opposed to the new Soviet Government and sold to the Soviet Government in 1925. After a period of initially rapid growth, operations of the bank declined sharply during the 1930s, reflecting both the bank's inability to attract Western deposits and its difficulty in generating lending opportunities. The bank closed with the onset of World War II and the occupation of Paris in 1940. [ ]

In 1948 BCEN reopened and grew rapidly, due largely to its pioneer role in the emerging Eurodollar market on behalf of Soviet and East European central

banks. Because of this aggressive money-market activity, it grew more rapidly than MNB and quickly surpassed it to become the largest of the Soviet-owned banks in the West and one of the top 10 banks in Paris. Eurobank is also very likely the most profitable of the Soviet overseas banks, probably because of its highly professional management. It maintains extensive correspondent relationships with Western banks, to which it provides profitable opportunities to engage 25X1 in East-West trade financing. Perhaps because of this, BCEN enjoys the best reputation of the Soviet-owned banks in the West. [ ] 25X1

**Table B-1**  
**Eurobank Balance Sheet <sup>a</sup>**

Million US \$

	1979	1980	1981	1982	1983
<b>Assets</b>					
Cash and notes due from banks	3,868.1	4,288.3	4,196.6	3,420.1	2,919.5
Loans and advances	1,071.8	1,204.4	1,063.6	1,147.3	1,710.0
Investments	363.7	339.0	219.2	220.6	39.8
Other assets	155.6	164.3	149.0	106.8	59.5
<b>Total</b>	<b>5,459.2</b>	<b>5,996.0</b>	<b>5,628.4</b>	<b>4,894.8</b>	<b>4,728.8</b>
<b>Liabilities and net worth</b>					
Deposits and notes due to banks	5,132.5	5,628.7	5,299.0	4,599.8	4,432.4
Other liabilities	213.6	257.0	220.2	193.9	189.5
Capital	92.6	88.6	97.4	89.2	96.8
Surpluses, profits, and reserves	20.5	21.7	11.7	11.8	10.1
<b>Total</b>	<b>5,459.2</b>	<b>5,996.0</b>	<b>5,628.4</b>	<b>4,894.8</b>	<b>4,728.8</b>

<sup>a</sup> Year-end data; because of rounding, components may not add to the totals shown. Data for 1979-82 are audited according to generally accepted accounting principles (GAAP); 1983 data are unaudited.

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**Secret****Table B-2**  
**Eurobank Income Statement <sup>a</sup>***Million US \$*

	1980	1981	1982
Banking revenue	661.3	707.3	567.4
Other revenue	0.2	0.2	0.3
<b>Total revenue</b>	<b>661.6</b>	<b>707.4</b>	<b>567.6</b>
Payroll expense	16.0	14.4	14.1
Banking expense	609.9	664.5	517.1
Occupancy expense	1.9	1.7	1.2
Loan loss provisions	10.5	9.1	18.7
Other expenses	5.4	4.8	4.5
<b>Total expenses</b>	<b>643.7</b>	<b>694.5</b>	<b>555.5</b>
Operating income	17.8	13.0	12.1
Taxes and other	7.2	4.3	4.2
<b>Net income</b>	<b>10.5</b>	<b>8.8</b>	<b>8.0</b>

<sup>a</sup> Bank data audited according to generally accepted accounting principles (GAAP); because of rounding, components may not add to the totals shown.

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**Table B-3**  
**Eurobank Peer Group Comparison, 1982 <sup>a</sup>***Million US \$*

	Total Deposits		Total Capital		Liquidity		Capital Adequacy (Capital/Assets)	Return on Income (Net Income/ Revenue)	Return on Equity (Net Income/ Capital)
	Million US \$	Rank in Peer Group	Million US \$	Rank in Peer Group	Quick Assets/ Deposits	Loans/ Deposits			
French peer group									
Eurobank	4,600	1	89	1	74	25	2	1	9
Societe Generale Alsacienne de Banque	4,367	2	59	4	48	58	1	1	8
Banque Worms	3,756	3	88	2	68	52	2	1	3
Societe Lyonnaise de Banque	3,107	4	63	3	57	58	2	1	8
Banque de L'Union Europeenne	2,171	5	55	5	67	128	1	6	NA
International peer group									
Eurobank, Paris	4,600	3	89	4	74	25	2	1	9
Bank fur Arbeit und Wirtschaft, Vienna	4,843	1	72	5	33	79	1	1	3
Sureiga Bank, Numazu	4,688	2	210	2	19	64	4	3	5
Istituto Bancario Italiano, Milan	4,009	4	96	3	34	51	2	1	8
Commercial Bank of Korea, Seoul	3,766	5	243	1	36	101	4	2	6

<sup>a</sup> Peer groups were generated on the basis of total assets at yearend 1981.

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Appendix C  
Wozchod Handelsbank (WHB)

History

The USSR opened Wozchod Handelsbank in Zurich in 1966—the first “independent” banking addition in the postwar period—ostensibly to finance Soviet-Swiss trade. However, it took on the primary task of enhancing the efficiency and secrecy of Soviet gold sales and providing firsthand analysis of the world gold market when the center of that market relocated to Zurich in 1968. The bank also operates as an interbank intermediary in the Eurocurrency markets much as Eurobank does. Accordingly, only a relatively small proportion—less than one-third—of its resources are devoted to direct financing of East-West trade. Wozchod’s paid-in capital has become large—to the point that some banking analysts believe the

bank is overcapitalized relative to the volume of its business. Any detailed examination of Wozchod is impeded by the bank’s near-total silence on its activities, possibly reflecting the key role the bank plays in marketing Soviet gold.

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Table C-1  
Wozchod Handelsbank Balance Sheet <sup>a</sup>

Million US \$

	1979	1980	1981	1982	Third Quarter 1983
<b>Assets</b>					
Cash and notes due from banks	18.1	18.7	78.9	35.8	38.4
Loans and advances	385.3	411.4	425.6	393.5	422.2
Investments	14.1	16.7	15.7	15.5	16.6
Other assets	73.2	57.4	40.4	55.4	59.3
<b>Total</b>	<b>490.7</b>	<b>504.2</b>	<b>560.6</b>	<b>500.2</b>	<b>536.5</b>
<b>Liabilities and net worth</b>					
Deposits and notes due to banks	387.7	407.3	453.8	398.3	439.4
Other liabilities	47.0	41.9	37.0	35.2	33.0
Capital	28.5	25.6	36.5	32.0	30.6
Surpluses, profits, and reserves	27.5	29.4	33.1	34.8	33.3
<b>Total</b>	<b>490.7</b>	<b>504.2</b>	<b>560.6</b>	<b>500.2</b>	<b>536.5</b>

<sup>a</sup> Yearend data; because of rounding, components may not add to the totals shown. Data for 1979-81 are audited according to generally accepted accounting principles (GAAP); 1982 and 1983 data are unaudited.

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**Table C-2***Million US \$***Wozchod Handelsbank Income Statement <sup>a</sup>**

	1980	1981	1982
Interest income	37.9	54.4	40.5
Securities income	0.5	0.7	2.4
Commission income	1.1	1.4	1.1
Foreign exchange and precious metals income	11.5	9.2	10.0
<b>Total revenue</b>	<b>51.0</b>	<b>65.7</b>	<b>53.9</b>
Interest expense	39.5	53.5	36.8
Commission expense	0.7	1.0	0.7
Payroll expense	2.2	2.4	2.3
Occupancy expense	1.8	1.8	1.5
Depreciation and loan loss provisions	0.1	0.1	5.9
<b>Total expenses</b>	<b>44.3</b>	<b>58.8</b>	<b>47.2</b>
Operating income	6.7	6.9	6.7
Taxes	1.8	2.1	1.6
<b>Net income</b>	<b>4.8</b>	<b>4.8</b>	<b>5.1</b>

<sup>a</sup> 1980 and 1981 data are audited according to generally accepted accounting principles (GAAP); 1982 data are unaudited; because of rounding, components may not add to the totals shown.

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**Table C-3****Wozchod Handelsbank Peer Group Comparison, 1982 <sup>a</sup>**

	Total Deposits		Total Capital		Liquidity		Capital Adequacy (Capital/Assets)	Return on Income (Net Income/ Revenue)	Return on Equity (Net Income/ Capital)
	Million US \$	Rank in Peer Group	Million US \$	Rank in Peer Group	Quick Assets/ Deposits	Loans/ Deposits			
Swiss peer group									
Wozchod Handelsbank	398	2	32	4	9	99	8	10	16
Arab Bank Overseas	441	1	39	2	52	38	7	7	10
Banque Compafina	387	4	51	1	28	97	11	3	4
Rothschild Bank	297	5	35	3	70	33	9	9	15
Glarner Kantonal Bank	389	3	17	5	12	92	4	7	10

<sup>a</sup> Peer groups were generated on the basis of total assets at yearend 1981.

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## Appendix D

### Ost-West Handelsbank (OWHB)

#### History

Ost-West Handelsbank opened in Frankfurt in 1971 with the stated mission of financing West German-Soviet trade in particular, and East-West trade in general. There probably were two additional but undeclared motives for Moscow placing a bank in Frankfurt. First, it gave the USSR ready access to the nearby international diamond market. Second, the Frankfurt locale provided additional access to Eurocurrency markets. The appointment of Andrey Dubonosov as chairman underscored the unstated Eurocurrency trading goals of the bank. Dubonosov, while chairman of MNB from 1959 to 1967, earned a reputation in Western banking circles as an expert in Euromarket trading. (His recall from retirement to fill this post also underscores the relative scarcity of competent Soviet banking personnel in the 1970s.)

The bank has been very active in financing and documentation of West German-Soviet trade—approximately 85 percent of its assets are short-term trade credits placed with West German banks. Although Ost-West was able to avoid involvement in the major banking scandals that affected its sister banks—MNB and Donau—in the mid-1970s, it did make at least one disastrous venture. In 1975 the Frankfurt-based bank financed the construction and operations of a new West German diamond exchange that went bankrupt in 1976, resulting in considerable bad press for the bank as well as loan losses. Currently, the bank makes much of its profit from document-processing fees for services in support of East-West trade.

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Ost-West grew rapidly throughout the 1970s, in part because of flourishing West European-Soviet trade.

**Table D-1**  
**Ost-West Handelsbank Balance Sheet <sup>a</sup>**

*Million US \$*

	1979	1980	1981	1982	1983
<b>Assets</b>					
Cash and notes due from banks	278.6	165.5	233.6	242.5	111.8
Loans and advances	823.9	838.8	615.2	526.2	573.8
Investments	13.2	8.1	1.8	6.3	1.4
Other assets	3.8	2.1	1.5	0.8	0.7
<b>Total</b>	<b>1,119.5</b>	<b>1,014.4</b>	<b>852.1</b>	<b>775.9</b>	<b>687.7</b>
<b>Liabilities and net worth</b>					
Deposits and notes due to banks	1,068.4	968.4	810.9	736.9	653.0
Other liabilities	0.1	0.1	0.1	0.1	0.1
Capital	37.6	33.2	28.8	27.4	23.9
Surpluses, profits, and reserves	13.4	12.7	12.4	11.6	10.5
<b>Total</b>	<b>1,119.5</b>	<b>1,014.4</b>	<b>852.1</b>	<b>775.9</b>	<b>687.7</b>

<sup>a</sup> Unaudited yearend data; because of rounding, components may not add to the totals shown.

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**Table D-2**  
**Ost-West Handelsbank Income Statement <sup>a</sup>**

Million US \$

	1981	1982	1983
Loan income	91.0	88.9	53.6
Security income	2.3	3.0	2.8
Commission income	2.5	2.1	2.0
Foreign exchange income	1.0	0.8	1.1
<b>Total revenue</b>	<b>96.7</b>	<b>94.7</b>	<b>59.5</b>
Payroll expense	3.5	3.2	3.1
Commission expense	0.1	0.1	0.1
Interest expense	82.9	80.8	45.5
Occupancy expense	0.2	0.1	0.2
Other expenses	1.9	1.8	1.7
<b>Total expenses</b>	<b>88.4</b>	<b>85.9</b>	<b>50.5</b>
Operating income	8.3	8.8	9.0
Taxes and extraordinary items	7.5	8.0	8.2
<b>Net income</b>	<b>0.8</b>	<b>0.8</b>	<b>0.7</b>

<sup>a</sup> Unaudited data as reported by the bank; because of rounding, components may not add to the totals shown.

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**Table D-3**  
**Ost-West Handelsbank Peer Group Comparison, 1982 <sup>a</sup>**

	Total Deposits		Total Capital		Liquidity		Capital Adequacy (Capital/Assets)	Return on Income (Net Income/ Revenue)	Return on Equity (Net Income/ Capital)
	Million US \$	Rank in Peer Group	Million US \$	Rank in Peer Group	Quick Assets/ Deposits	Loans/ Deposits			
West German peer group									
Ost-West Handelsbank	737	3	27	1	33	71	4	1	3
Karl Schmidt Bankgesellschaft	767	1	34	1	20	83	4	NA	NA
Stadt-Sparkasse Solingen	743	2	28	5	9	97	3	3	8
Handelsbank in Lubeck	663	4	32	3	17	98	4	2	5
Effectenbank-Warburg	605	5	30	4	31	86	5	1	3

<sup>a</sup> Peer group was generated on the basis of total assets at yearend 1981.

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Appendix E  
Donaubank

History

The Donaubank opened in Vienna in 1974 after nearly a decade of intergovernmental negotiations. The Austrians welcomed the bank because it enhanced Vienna's reputation as a major center for East-West trade. Donaubank was, however, issued only a limited charter to conduct bank operations. Donau was restricted in terms of local activities; it was not allowed to offer savings accounts, issue mortgage bonds, or trade in mutual funds. The bank was, however, allowed to operate freely in trade financing, foreign exchange, and Eurocurrency operations. [redacted]

transactions unrelated to East-West trade. The loans causing this catastrophe were made to two Austrian concerns—a plastics firm and a private bank—both of which folded soon after the loans were made. Following these episodes, Donau's shareholders—Gosbank and Vneshtorgbank—issued additional capital to keep the bank afloat and replaced several senior Soviet bank officials including the chairman of the board. Since that initial year, the bank has more conservatively concentrated on the direct financing of and documentary services related to Austrian trade with the USSR and other CEMA member countries. [redacted]

Donau got off to a bad start, losing its entire capital of about \$5 million in the first 10 months of operation in

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Table E-1  
Donaubank Balance Sheet <sup>a</sup> Million US \$

	1979	1980	1981	1982	1983 <sup>b</sup>
<b>Assets</b>					
Cash and notes due from banks	175.2	91.3	176.4	198.6	216.5
Loans and advances	119.8	183.1	227.1	264.0	287.8
Investments	9.6	7.5	10.1	14.0	14.7
Other assets	6.9	5.8	6.6	5.5	16.0
<b>Total</b>	<b>311.5</b>	<b>287.7</b>	<b>420.2</b>	<b>482.1</b>	<b>535.2</b>
<b>Liabilities and net worth</b>					
Deposits and notes due to banks	294.9	271.8	389.9	451.7	501.9
Other liabilities	8.0	7.8	12.3	13.2	14.6
Capital	8.1	7.5	17.4	16.5	17.9
Surpluses, profits, and reserves	0.5	0.6	0.6	0.7	0.8
<b>Total</b>	<b>311.5</b>	<b>287.7</b>	<b>420.2</b>	<b>482.1</b>	<b>535.2</b>

<sup>a</sup> Unaudited yearend data as reported by the bank; because of rounding, components may not add to the totals shown.  
<sup>b</sup> 1983 data are estimated on the basis of 1980-82 trends.

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**Table E-2**  
**Donaubank Income Statement <sup>a</sup>**

Million US \$

	1980	1981	1982
Interest income	37.1	47.3	53.4
Commission income	1.1	0.8	1.0
<b>Total revenue</b>	<b>38.1</b>	<b>48.1</b>	<b>54.3</b>
Interest expense	34.6	44.1	48.0
Payroll expense	1.4	1.4	1.6
Occupancy expense	0.3	0.2	0.2
Depreciation and reevaluation	1.2	1.6	3.5
<b>Total expenses</b>	<b>37.5</b>	<b>47.3</b>	<b>53.3</b>
Operating income	0.1	0.1	0.1
Taxes and extraordinary items	0.0	0.0	0.0
<b>Net income</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>

<sup>a</sup> Unaudited yearend data as reported by bank; because of rounding, components may not add to the totals shown.

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**Table E-3**  
**Donaubank Peer Group Comparison, 1982 <sup>a</sup>**

	Total Deposits		Total Capital		Liquidity		Capital Adequacy (Capital/Assets)	Return on Income (Net Income/ Revenue)	Return on Equity (Net Income/ Capital)
	Million US \$	Rank in Peer Group	Million US \$	Rank in Peer Group	Quick Assets/ Deposits	Loans/ Deposits			
Austrian peer group									
Donaubank	452	1	17	1	44	58	4	0.2	0.6
Adria Banking	103	2	5	3	70	48	5	1.0	1.0
Bank Gebruder Gutmann	28	3	1	5	30	60	4	0.0	7.0
Internationale Bank fur Aussenhandel	25	4	4	4	NA	NA	1	1.0	6.0
Central Wechsel und Creditbank	15	5	6	2	NA	NA	2	1.0	3.0

<sup>a</sup> Peer group was generated on the basis of total assets at yearend 1981.

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Appendix F

East-West United Bank (EWUB)

History

The Luxembourg-based bank—chartered as Banque Unie Est-Ouest—is the newest of the Soviet-owned banks in the West, having opened its doors in 1974. This bank’s purpose was to finance Soviet trade with the Benelux countries and other European Economic Community (EEC) members. Able to take advantage of its location in the rapidly expanding EEC financial center—home to the EEC currency fund, the Euro-bank clearing system, and primary and secondary foreign exchange markets—EWUB demonstrated rapid growth in assets, mostly interbank deposits, surpassing even its sister banks during the mid-1970s. Luxembourg also permitted it to engage in some

forms of banking operations that were forbidden to Ost-West Handelsbank by West German law. Until almost the end of the decade, East-West was very active in syndicated Eurocurrency loans and the *à forfait* market. Although East-West United began as a rising star among the Soviet-owned banks, it currently enjoys a poor reputation among Western bankers—perhaps reflecting its poor profitability and inactivity in the financial marketplace.

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Table F-1

East-West United Bank Balance Sheet <sup>a</sup>

Million US \$

	1979	1980	1981	1982	1983
<b>Assets</b>					
Cash and notes due from banks	448.3	533.7	581.3	478.9	444.6
Loans and advances	72.6	65.7	62.1	44.0	27.0
Investments	6.1	10.8	10.1	7.3	4.1
Other assets	16.7	21.9	24.6	17.3	11.4
<b>Total</b>	<b>543.7</b>	<b>631.9</b>	<b>677.9</b>	<b>547.5</b>	<b>487.1</b>
<b>Liabilities and net worth</b>					
Deposits and notes due to banks	503.8	589.2	636.6	506.4	447.6
Other liabilities	8.9	11.1	16.9	10.5	7.0
Capital	27.5	28.3	22.0	22.6	20.2
Surpluses, profits, and reserves	3.5	3.3	2.4	8.0	12.3
<b>Total</b>	<b>543.7</b>	<b>631.9</b>	<b>677.9</b>	<b>547.5</b>	<b>487.1</b>

<sup>a</sup> Unaudited yearend data as reported by the bank; because of rounding, components may not add to the totals shown.

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**Table F-2**  
**East-West United Bank Income Statement <sup>a</sup>**

Million US \$

	1981	1982	1983
Interest and commission revenue	91.5	90.6	54.5
Other revenue	1.6	1.5	0.6
<b>Total revenue</b>	<b>93.0</b>	<b>92.1</b>	<b>55.2</b>
Payroll expense	1.2	1.2	1.1
Interest and commission expense	88.4	84.8	46.7
Depreciation	0.2	0.2	0.1
Loan loss provisions	1.7	4.4	5.8
Other expenses	0.5	0.4	0.5
<b>Total expenses</b>	<b>91.9</b>	<b>90.9</b>	<b>54.1</b>
Operating income	1.1	1.2	1.1
Taxes and extraordinary items	0.6	0.7	0.7
<b>Net income</b>	<b>0.5</b>	<b>0.5</b>	<b>0.4</b>

<sup>a</sup> Unaudited yearend data as reported by the bank; because of rounding, components may not add to the totals shown.

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**Table F-3**  
**East-West United Bank Peer Group Comparison, 1982 <sup>a</sup>**

	Total Deposits		Total Capital		Liquidity		Capital Adequacy (Capital/Assets)	Return on Income (Net Income/ Revenue)	Return on Equity (Net Income/ Capital)
	Million US \$	Rank in Peer Group	Million US \$	Rank in Peer Group	Quick Assets/ Deposits	Loans/ Deposits			
Luxembourg peer group									
East-West United Bank	506	4	23	1	95	9	4	1	2
Westfalenbank International	553	1	16	4	34	3	3	0	1
Trinkaus and Burkhardt International	553	1	14	5	40	71	2	1	6
Societe Europeenne de Banque	515	3	19	3	68	48	4	2	7
Provinsbanken International	505	5	22	2	29	66	4	4	10

<sup>a</sup> Peer group was generated on the basis of total assets at yearend 1981.

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